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JAPAN: Headed for a Record Trade Surplus

Japan's strong showing in 1981 will set the stage for a record trade and current account surplus this year. Although export growth has been moderating, imports have also been declining because of energy conservation, sluggish domestic demand, and falling raw material prices. Imports will pick up this year, but the increase will not match the moderate boost expected on the export side and as a result Japan should record an \$18 billion current account surplus. [REDACTED]

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Tokyo has recently announced a trade policy package to deal with the mounting criticism over Japan's rising surplus. The plan includes both long- and short-term measures but will only have a marginal impact on the 1982 surplus and will not substantially change Japan's agricultural nontariff barriers. [REDACTED]

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Results for 1981

Japan's current account surplus probably reached \$7 billion last year, compared with an \$11 billion deficit in 1980. On the strength of ship, motor vehicle, and consumer electronics exports, volume probably increased 11 percent, below the 1980 pace of 18 percent but fast enough to expand Japan's share of world trade. While sales to the United States, Western Europe, and OPEC recorded substantial gains, the largest increase was to Latin America, with a 25 percent jump in automobile exports. This move reflects efforts by Japanese producers to counter the impact of automobile restraint agreements with the US and EC. [REDACTED]

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Japan's export success can be attributed to continued improvements in its price competitiveness. Yen depreciation against the dollar and a relatively small increase in unit labor costs produced a 10 percent improvement in Japan's competitive position in January-November 1981, measured by its price adjusted, trade-weighted exchange rate. In practical terms, Japanese producers took advantage of the yen's fall by lowering dollar export prices 6 percent through October. [REDACTED]

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On the import side, volume declined 2.5 percent because of higher import prices, sluggish domestic demand, and energy conservation. Oil imports fell nearly 10 percent reflecting Japan's shift toward coal, low output levels in energy intensive industries, and favorable weather in 1980 and 1981. The current slump in such raw-material intensive industries as aluminum resulted in a decline in both the volume and value of raw material imports and a drawdown in inventories. [REDACTED]

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Outlook for 1982

We expect Japan's trade and current account surplus to increase even more in 1982, reaching \$35 billion and \$18 billion respectively. Such results would exceed the previous records of \$25 billion and \$17 billion posted in 1978. Our forecast assumes that world trade will expand roughly 5 percent, and that the yen will appreciate somewhat. [REDACTED]

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Export growth while remaining strong will continue to decelerate because of trade barriers and sluggish economies in key market countries. Volume should expand 8 percent.

- With huge order backlogs, exports of ships should increase by nearly 20 percent.
- Consumer electronic exports should jump 20-25 percent. This growth will be paced by sales of video tape recorders (VTR's) and television sets. Sales of VTR's alone should nearly double.
- Motor vehicle exports should grow by 7 percent in value and 3 percent in volume. Although Japan is increasing shipments of high-priced luxury models to the United States, higher sales of the less-expensive models in other markets should keep the increase in unit value to 4 percent on average.

- Iron and steel exports should post little gain because of sluggish demand and increased competition from South Korea and Taiwan in the common grades of carbon steel. Steel export volume should remain at about 28 million metric tons with prices relatively unchanged.
- Chemical exports are likely to decline by about 5 percent in volume terms, in part because US and Canadian producers are eating into Japan's traditional market in Southeast Asia. [redacted]

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Some Rebound in Imports

We expect import volume to bounce back this year; the increase should approximate 4 percent. The underlying reason for this growth is a general, albeit small, improvement in domestic Japanese demand. Japan's import bill should expand about 7 percent in value, reaching nearly \$136 billion.

- Mineral fuel imports, accounting for more than half of Japan's import bill, will increase about \$3.5 billion. In volume terms, oil imports should increase 2 percent because of some pickup in economic activity. Coal conversion in the cement and steel industries, should push imports of coal up 8 percent.
- Agricultural imports (10 percent of total imports) will increase by about 4 percent in volume and value.
- Because inventory adjustment has largely run its course and industrial production should increase about 3 percent, raw material imports (about 20 percent of total imports) should grow 4 percent in volume; with world markets still soft we expect at best a 5 percent increase in price.
- Manufactured imports (20 percent of imports) should increase by 11 percent in value as both private consumption and business investment pickup. Volume should grow about 3 percent. [redacted]

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The Bilateral Surplus

Japan's trade surplus with the United States will also continue to increase. Through November, Japan's trade surplus with the United States was \$15 billion, compared to \$9 billion

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last year; it could reach \$17 billion in 1981 and expand at least another several billion dollars in 1982. The mounting surplus largely reflects the yen's 10 percent depreciation against the dollar since January. Japanese competitiveness has actually increased faster in the US than in other markets. The depreciation, at the same time, has retarded imports from the United States. Export price increases, particularly for motor vehicles, and increased shipments of consumer electronics will push export revenue higher in 1982. At the same time, weak prices for agricultural products, accounting for about 30 percent of Japan's imports from the United States, will keep the lid on the bilateral import bill. [REDACTED]

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Uncertainties

If anything, our estimate of the current account is conservative. We expect Japanese oil imports to increase 2 percent, but they may not reach that level if Tokyo allows some inventory drawdowns or industry continues to make gains in conservation. In that event, Japan's import bill would come in several billion dollars below our estimate. On the export side, if the US car market recovers, Japanese shipments could expand faster than we expect. [REDACTED]

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The downside risk is the depth and duration of the recession in the OECD. If world trade does not expand 5 percent as we have assumed, Japan's export receipts will be lower. Because of yen depreciation and low inflation, however, Japan's market share would not suffer proportionately with a dropoff in world imports. Moreover, lower export prospects would also trim import demand particularly for raw materials. All things considered, if world trade were to increase only three percent in 1982 we would expect Japan to post a \$15 billion current account surplus.

Tokyo's Reaction

Tokyo has recently adopted a five point trade policy package in order to reduce the trade surplus and ease trade friction with the United States and the EC. The announced measures are designed to promote imports but will only have a marginal impact on Japan's 1982 trade surplus. The package includes:

- An acceleration of tariff cuts agreed to in the Tokyo Round.
- Subsidies for raw material stockpiling even though

Japanese companies probably would have rebuilt inventories anyway.

- \$330 million in funds already in the budget for increased oil reserves.
- A maximum of \$500 million in foreign currency loans for emergency imports on the condition that the yen appreciates.
- A reported \$90 million could be available to purchase foreign grain to be used as food aid. [REDACTED]

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The plan also makes some vague promises for long-term solutions to the trade problem, such as improvements in import inspection procedures. These measures, however, are only under review and more details are expected in late January. Specific proposals under consideration include the acceptance of foreign test data for cosmetics, pharmaceuticals, food additives, and automobiles. Substantial changes in agricultural quotas, which would require a political decision on Suzuki's part, are unlikely. [REDACTED]

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Japan: Current Account and Trade Balances (Billions of US \$)

	<u>1980</u>	<u>% Change</u>		<u>1981</u>	<u>% Change</u>		<u>1982</u>
		<u>in Price</u>	<u>in Volume</u>		<u>in Price</u>	<u>in Volume</u>	
Exports	125.9	7	11	149.5	6	8	171.1
Imports	124.2	5	-2.5	127.1	3	4	136.1
Trade Balance	1.7			22.4			35
Services & Transfers	-12.9			-15.5			-16.5
Current Account Balance	-11.2			6.9			18.5